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17 August 2015

The Commerce Commission
PO Box 2351
WELLINGTON 6140
Attn: Alex Sim
Chief Adviser, Regulation Branch
c/o regulation.branch@comcom.govt.nz

Dear Alex

DAIRY COMPETITION REVIEW CONSULTATION PAPER, 20 JULY 2015

This submission is made by Foodstuffs (NZ) Ltd on behalf of the Foodstuffs group of companies [Foodstuffs] including Foodstuffs North Island Limited, Foodstuffs South Island Limited, and Foodstuffs Own Brands Limited.

Foodstuffs North Island Limited and Foodstuffs South Island Limited are retailer owned co-operatives. Members of each co-operative operate supermarkets and grocery stores trading under the following brands: PAK'nSAVE, New World, Four Square, Raeward Fresh, and On the Spot.

Foodstuffs has an interest in the current review as a retailer of fresh milk and other dairy products. We also have an interest as the brand-owner of private label ranges which include dairy products, the supply of which is contract manufactured on our behalf.

Foodstuffs views on the specific matters raised in the consultation document

1. The markets upon which the Commerce Commission intends to focus, and the relative extent of that focus

The review is focused on the farm gate and factory gate markets for dairy products in New Zealand and we agree this focus is right. The Dairy Industry Restructuring Act 2001 (DIRA) was enacted along with associated regulations in recognition that the formation of Fonterra would substantially lessen competition in these markets, to the extent that market regulation was justified. While we are not involved in the farm gate market, and therefore cannot comment on it, we believe the regime has delivered effective competition at the factory gate. Notwithstanding, after fourteen years of regulation it is appropriate to review these markets and reassess the need for ongoing regulation.

It is our view that the downstream markets for dairy products (further processing, wholesaling, and retail markets) operate with effective competition. In regard to the market for retail milk, the Commerce Commission conducted a separate, specific, investigation in 2011 and found that the market was workably competitive. There have been no structural or other changes in the retail milk market since 2011 to change this position.

2. The definition of farm gate and factory gate

The Commerce Commission has adopted the following definitions:

- The farm gate market is the market for the supply of raw milk by farmers to dairy processors
- The factory gate market is the market for the supply of raw milk, collected by dairy processors, to other processors.

Foodstuffs is comfortable with these definitions.

3. What the state of competition is at the farm gate, factory gate and downstream markets

As stated before, Foodstuffs does not participate in the farm gate market and is therefore unable to comment meaningfully on it. Accordingly we limit our comments to the factory gate market.

Foodstuffs negotiates the supply of fresh milk and basic commodity-type products for its private label ranges: Pams and Budget. The market for fresh milk is different to that for further processed product and we comment on them separately.

In regard to the consumer market for fresh milk, supply is negotiated on an island basis. The nature of the product (short shelf life and high perishability) and market dynamics (limited South Island processing facilities), means that it is advantageous for the companies to organise supply on a separate basis.

Currently there are only two suppliers, Fonterra Brands and Goodman Fielder, who have sufficient scale and geographic coverage to satisfy the companies' requirements for the supply of private label milk. Supply contracts are periodically tendered by each Company and this tendering process ensures that competitive tension occurs. Our view is that there is effective competition between the two potential suppliers in pitching for the companies' business. Notwithstanding, we would prefer that there were more suppliers competing for this business. Supermarket private label milk is the cost leader in the category and holds the largest share of the retail market for fresh milk and this presence in the market places price pressure on other market participants. Private label supply is therefore extremely important in promoting competition in the retail market for fresh milk.

We hold the view that the DIRA regulations remain pivotal in ensuring that Fonterra Brands has an effective competitor in the factory gate market for milk. The obligation to supply Goodman Fielder ensures that Goodman Fielder has sufficient product to be able to compete for supermarket private label business. In the absence of regulation, we are not confident that Goodman Fielder would be able secure sufficient raw milk supply to tender for this business, at least in the short term. Importing is not feasible due to the nature of the product. We therefore anticipate that the dismantling of the regulations would substantially lessen competition, at least in the short term, while Goodman Fielder organised alternate supply of the raw product. In the longer term, we believe it would be advantageous if Goodman Fielder and other suppliers were able to compete with Fonterra Brands without relying on it for the supply of their raw material.

Foodstuffs private label ranges also include further processed dairy products including: butter, cheddar-style cheeses, and ice-cream. Supply arrangements are tendered nationally by Foodstuffs Own Brands Limited. The market for the supply of these products is competitive with a larger number of suppliers tendering for this business, however we do not have full visibility over the degree to which these companies rely on Fonterra for the supply of raw material. As with fresh milk, private label products provide additional competitive pressure for the proprietary brands and therefore fulfil an important role in fostering market competition.

4. The evolution of competition in the relevant dairy markets since Fonterra was established and since the Government's 2010 review of competition in the dairy industry

Over the last ten or so years a number of new market participants have emerged for both fresh milk and further processed product and we now see a lot more product differentiation in the various dairy categories. There is a spectrum of processing involved – some companies buy commodity products from the large suppliers and add value by way of packaging innovation and design, product branding etc. Others differentiate themselves in terms of new product innovation through a focus on new product development. Generally speaking the greater the level of specialty e.g. fancy cheeses, the greater the number of market participants. These value-added products extend consumer choice and convenience but usually sell at a premium to the commodity products and therefore do not compete with commodity products on pricing.

5. Our views on Fonterra's incentives to, and/or ability to exercise market power without the regulations

Fonterra retains a high degree of market power by virtue of its dominance in the collection and onward supply of raw milk. In the absence of regulation we anticipate it would have little incentive to continue to supply its competitors. In this context, effective competition would depend upon its competitors' ability to secure their own supplies of raw milk directly from farmers. We do not have sufficient knowledge of this level of the market to provide a view on the feasibility of Fonterra' competitors being able to make this transition in seamless fashion; however we perceive considerable risks would be involved, at least in the short term.

6. The specific changes to the regulations that could make the farm gate and factory gate more efficient and better promote the purpose of the DIRA

As we are a step removed from the operation of the regulations, other parties are better placed to comment on this question.

7. What economic inefficiencies are caused by existing regulations, and how could these inefficiencies be mitigated

We understand that, when first introduced, the regulations were designed to be a short-to medium term intervention to ensure continued supply of raw milk to Fonterra's competitors to facilitate continued competition in domestic dairy markets, and that it was envisaged that, over time, its competitors would develop their own arrangements for supply of raw milk (direct procurement from farmers) enabling the regulations to eventually be repealed. While the regulations have been effective in ensuring competition at the factory gate, Fonterra's competitors have not made the transition to independent supply arrangements as anticipated. It is likely that the regulations have impeded this transition because their very existence has encouraged dependence upon them. While we do not support the immediate dismantling of the regulations, due to the considerable risk this carries, there may be some merit in looking at how they could be fine-tuned to reduce this dependency over time.

8. Whether there are any redundant or ineffective regulations in terms of promoting the efficient operation of the dairy markets

See comments above.

9. The regulations that we would be concerned about being removed or altered, and why

See comments above.

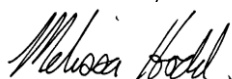
10. How deregulation may potentially impact on downstream markets

We are concerned that deregulation carries a high level of risk that Fonterra would be able to monopolise domestic dairy markets, at least in the short term, due to its dominance in the supply of raw milk. In this case we would expect to see price increases for raw milk which would flow through to price increases in downstream markets and ultimately at the supermarket checkout. There is also considerable risk that some of Fonterra's competitors, particularly those lacking scale, would fail, leading to reduced consumer choice. As the smaller companies also lead new product development, the level and speed of product innovation might also reduce to the disadvantage of domestic consumers.

11. Any other issues we believe that the Commerce Commission should consider

We have no further comments to make at this time, however Foodstuffs remains willing to answer any further questions the Commerce Commission may wish to raise with us.

Yours sincerely



Melissa Hodd
Executive Manager